

NOTE: Revisions to the 12/7/99 OUTLINE are underscored.

OUTLINE
ACT 71, SLH 1999 AND ACT 198, SLH 2000
General Excise Tax (GET) Pyramiding Relief
Public Service Company (PSC) Tax Pyramiding Relief
Prepared by DOTAX, State of Hawaii

I. EXISTING LAW ON SERVICES TRANSACTIONS

- Transactions currently eligible for ½% rate are **not** affected by ACT 71 and ACT 198.

A. Property-to-Service Transactions (HRS § 237-4(8) Wholesale Sales of Tangible Personal Property (TPP) to a Service Provider)

1. GET rate: ½%
2. Must satisfy the following three prong test:
 - a. TPP cannot be consumed or incidental to the performance of the service;
 - b. TPP must be resold at 4%; and
 - c. The resale of the TPP must be separately charged or billed by the person rendering the service.

Ex (1): Floor mats sold to auto body shop for Customer's car qualifies.

Ex (2): Paint sold to auto body shop for Customer's car does not qualify.

Ex (3): Area rug sold to Interior Designer for placing in Customer's lobby qualifies.

Ex (4): Fabric sold to Interior Designer for covering Customer's lobby sofa does not qualify.

B. Service-to-Service Transactions (HRS § 237-13(6) Intermediary Services)

- Strict consumption rules adopted by the courts disqualify most transactions from the ½% rate.

1. GET rate: ½%
2. Must satisfy the following test:
 - a. The service provider performs a service;
 - b. Upon the request or order of another service business which acts as an intermediary between the service provider and the ultimate customer of the service;
 - c. Both the service provider and intermediary are licensed persons in the State;
 - d. There are at least three parties; and
 - e. The gross income received by the intermediary from the ultimate customer is subject to the GET at the 4% rate.

Ex (5): Auto body shop subs entire car project to another auto body shop qualifies.

Ex (6): Auto body shop subs sandblasting the car to another auto body shop does not qualify.

Ex (7): Interior Designer subs entire project to another designer qualifies.

C. Service-to-Property Transactions (HRS § 237-18(c) Services Used in the Manufacture of Products)

1. GET rate: ½%
2. Must satisfy the following test:
 - a. The service provider is taxable under HRS § 237-13(6);

- b. Mills, processes, or otherwise manufactures a product;
- c. Upon the order of a manufacturer who is taxable upon the entire value of the manufactured product which consists in part of the value of the services rendered by the service provider.

Ex (8): Casting service that creates foam core for surfboards for manufacturer qualifies.

Ex (9): Freight service that delivers casted cores to a manufacturer does not qualify (PSC).

Ex (10): Embossing service that applies a design to handbags for a manufacturer qualifies.

Ex (11): Artist contracted by fabric manufacturer to produce textile illustrations that serve as blueprints for printing designs on fabric qualifies.¹

II. EXPANSION OF GET WHOLESALE RATE UNDER ACT 71 AND ACT 198

- The intent of Act 71 is to alleviate general excise tax pyramiding on service type transactions by treating those transactions similar to the wholesale sales of TPP. The law does not affect those transactions that currently qualify for the ½% rate under HRS § 237-13(6).
- Qualifying transactions subject to 7-year phase-in of rates provided in Act 71.
- Act 198 extends GET pyramiding relief to sale of amusements.

A. HRS § 237-4(a)(8) Property-to-Services Transactions

1. Grandfathers transactions that qualify under the **old three prong test** (HRS § 237-4(8)(a)) during the 7-year phase-in period.
 - Remains subject to ½% rate.
2. **New test** qualifies other transactions for a lower GET rate.
 - a. Transactions that qualify:

Tangible personal property sold upon order or request of a licensed seller for purpose of:

 - Restates old law rule for resale, but without need for separate statement.

(1) Rendering services (HRS § 237-13(6))

 - TPP-to-service transactions
 - Ex (12):** Paint sold to auto body shop for Customer's car qualifies.
 - Ex (13):** Fabric sold to Interior Designer for covering Customer's lobby sofa qualifies.
 - Ex (14):** Developer used in photo processing of photograph does not qualify (photo processing is manufacturing, not services, but qualifies for ½% under current law).

(2) Furnishing transient accommodations (HRS § 237-13(10));

 - TPP-to-transient accommodations transactions
 - Ex (15):** Toiletries sold to hotel for in-room guest use qualifies.
 - Ex (16):** Toiletries sold to hotel for public restroom use does not qualify (not for transient accommodations).
 - b. TPP becomes an **"identifiable element"** of services rendered
 - Eases strict consumption rule--some consumption tolerated; and
 - Ex (17):** Toner and paper identifiable on a copy service copy qualifies.
 - c. **"Overhead"** not eligible.

¹ Example from Technical Section draft letter to Carole G. Hara dated June 2, 2000.

Defined as general and continuous costs occurring in the normal course of business, including but not limited to costs for labor, rent, taxes, royalties, interest, discounts paid, insurance, lighting, heating, cooling, accounting, legal fees, equipment and facilities, telephone systems, depreciation, and amortization.

Ex (18): Security, janitorial services, utilities, maintenance contracts on office machines, and accounting and legal services do not qualify.

Ex (19): Monthly telephone service does not qualify (overhead and PSC).

Ex (20): Paper in CPA's copying machine used to make duplicate tax returns for client does not qualify. (Compare Ex 17 on page 2, section II.A.2.b.)

d. Transaction not subject to income splitting or a deduction under the GET or the TAT. See page 7, section IV. B. 7 of this outline.

e. The resale of the services must be subject to the GET at the 4% rate.

B. HRS § 237-4(a)(10) Mixed Services Transactions

1. Grandfathers transactions that qualify under the **old intermediary services test** (HRS § 237-13(6)) during the 7-year phase-in period;
 - Remains subject to ½% rate.
 - When phase-in completed, the old intermediary services test is repealed.
 2. Act 71 does not affect service-to-property transactions that qualify under HRS § 237-18(c) which remain subject to ½% rate (discussed in I.C.)
 3. **New test** qualifies other transactions for a **lower GET rate** subject to 7-year phase-in of rates.
 4. Transactions that qualify:
 - a. A service is rendered;
 - b. Upon the order or request of:
 - Restates old law rule that service must be resold.
- (1) A licensed seller rendering another service;
- Service-to-service transactions
- Ex (21):** Auto body shop subs sandblasting a car to another auto body shop qualifies.
- Ex (22):** Services of a CPA used by an attorney to prepare a legal opinion for a client qualifies.
- Ex (23):** Lab tests performed by independent laboratory that are requested by a physician for a patient's diagnosis qualifies.
- Ex (24):** Assume the same facts as Ex (23), except that the independent laboratory subcontracts one test to another laboratory. Both laboratories qualify for the lower GET rate. (Pyramiding relief under Act 71 and 198 applies to multi-level transactions such as this Ex (24) provided that the resale at retail is taxed at the four per cent (4%) rate.)
- (2) A licensed seller manufacturing, producing, preparing, or acquiring TPP;
- Service-to-TPP transactions
- Ex (25):** Design service that draws a design for a handbag manufacturer qualifies.
- Ex (26):** Freight service that delivers casted cores to manufacturer does not qualify (PSC).
- Ex (27):** Graphic artist who designs a graphic image to be applied to a coffee mug qualifies.

- Ex (28):** Graphic artist who designs a corporate logo to be applied to company coffee mugs, pencils, etc. does not qualify (logo is an intangible; overhead).
- Ex (29):** Engraver who inscribes wedding rings for a jeweler's customer qualifies.
- Ex (30):** Graphic artist who designs cover of a CD-ROM jewel case qualifies (canned software is TPP).
- Ex (31):** Tailor who alters suit for an original purchase by a clothing store's customer qualifies.
- (3) A licensed contractor for the purpose of assisting with a contracting project;
- Service-to-contracting transactions
- Ex (32):** Blueprints drawn by an independent drawing service for a contractor qualifies.
- Ex (33):** Blueprints drawn by an architectural firm does not qualify (subcontract deduction).
- Ex (34):** Grout pumping service pumping grout from trucks to contractor's forms qualifies.
- Ex (35):** Motor carrier hauling building material to contractor's project site qualifies for PSC pyramiding relief. See page 6, section III. B of this outline.
- Ex (36):** Hauling trash from a contractor's project site qualifies (non-PSC).
- Ex (37):** Security Co. providing security on project site qualifies (site specific).
- Ex (38):** Interior designer subs carpet removal to a carpet laying contractor does not qualify (resale of contracting, not a service); or
- (4) A person subject to TAT for purpose of furnishing transient accommodations (a room, suite, apartment, or the like);
- Service-to-transient accommodations transactions
- Ex (39):** Sheet and towel laundry service for hotel guest rooms qualifies.
- Ex (40):** Hula Halau performing in hotel lobby does not qualify (viewed free without admission; overhead; not resold).
- c. The benefit of the service passes to the customer of the licensed seller, contractor, or person furnishing transient accommodations.
- The final customer ultimately consumes the service.
- d. Service becomes an **"identifiable element"** of the service, TPP, contracting, or transient accommodations being sold to the customer.
- Eases strict consumption rule--some consumption is tolerated.
- e. **"Overhead"** not eligible.
- Defined as general and continuous costs occurring in the normal course of business, including but not limited to costs for labor, rent, taxes, royalties, interest, discounts paid, insurance, lighting, heating, cooling, accounting, legal fees, equipment and facilities, telephone systems, depreciation, and amortization.
- Ex (41):** Security Co. providing security on project site qualifies (site specific).
- Ex (42):** CPA's preparation of a legal firm's partnership tax returns does not qualify (overhead).
- Ex (43):** Hotel's procurement of employees from a leasing company to staff executive office does not qualify (overhead labor; not for furnishing a room).

- Ex (44):** Hotel's purchase of maid services from an independent contractor to clean guest rooms qualifies.
- f. Transaction not subject to income splitting or a deduction under the GET or the TAT. See page 7, section IV. B. 7 of this outline.
 - g. The resale of the service must be subject to the GET at the 4% rate.
- C. HRS § 237-4(a)(13) Amusement Transactions (Act 198)
- 1. Amusement transactions did not qualify for pyramiding relief under Act 71.
 - 2. Transactions that qualify:
 - a. An amusement taxable under HRS § 237-13(4) is rendered:
 - b. Upon the order or request of:
 - (1) A licensed seller rendering another service:
 - Amusement-to-service transactions
 - Ex (45):** Band or hula halau performing in hotel lobby or open area does not qualify. (Viewed free without admission charge; overhead to hotel)
 - Ex (46):** Band hired by bride and groom for their wedding reception at a hotel ballroom does not qualify. (2 party retail transaction).
 - (2) A licensed seller selling TPP:
 - Amusement-to-tangible personal property transactions
 - Ex (47):** Band hired by hotel events office to provide music for a dinner concert qualifies.
 - Ex (48):** Band hired by hotel catering office for customer's banquet at hotel ballroom qualifies. (Sale of food and beverage for the banquet is deemed to be an admission charge.)
 - Ex (49):** Band hired by hotel catering office for customer's rental of hotel ballroom does not qualify. (Amusement to rental does not qualify.)
 - (3) A licensed amusement business selling an amusement:
 - Amusement-to-amusement transactions
 - Ex (50):** Independent contractor DJ or VJ in night club (with cover charge) qualifies.
 - Ex (51):** Hula Halau providing entertainment (that cannot be viewed free by the non-paying public) as a part of a commercial luau qualifies. (Note: The hula halau did not qualify for pyramiding relief under Act 71 because the luau is classified for GET purposes as amusement, not services).
 - c. The benefit of the amusement passes to the customer of the licensed seller.
 - d. Service becomes an "identifiable element" of the service, TPP, or amusement being sold to the customer.
 - e. "Overhead" not eligible. Same definition as Act 71.
 - f. Transaction not subject to income splitting or a deduction under the GET or the TAT.
 - g. The resale of the service must be subject to the GET at the 4% rate.
 - 3. Act 198 defines the term "amusement" for GET pyramiding relief as entertainment provided as part of a show for which there is an admission charge. Subcontracted amusement with the sale of food and beverage is deemed to be an admission charge.
 - 4. Qualifying amusement transactions are subject to phase-in rates provided in Act 71. (See page 8 of this outline)

III. PUBLIC SERVICE COMPANY TAX PYRAMIDING RELIEF FOR
TELECOMMUNICATIONS SERVICES AND TRANSPORTATION SERVICES WHICH
ARE RESOLD (Act 198)

A. Telecommunications services resold by an interstate telecommunications provider.

➤ Transactions currently eligible for the ½% public service company (PSC) tax rate are **not** affected by Act 198.

1. The PSC tax is imposed on a public utility at a rate ranging from 5.885% to 8.2 %, based on a rising ratio of the public utility's net income to its gross income. Under current law, the gross income received by a public utility from the sale of its products or services to another public utility for resale is subject to the PSC tax at the ½% rate. The sale of telecommunications services by a public utility to an interstate telecommunications provider currently does not qualify for this ½% PSC rate because the interstate telecommunications provider is not classified as a public utility under the PSC tax. The interstate telecommunications provider is subject to the GET instead of the PSC tax.
2. Beginning with the January 1, 2001 filings, the sale of telecommunications services by a public utility to an interstate telecommunications provider who is subject to the GET and who resells the services to retail customers, is subject to a 5.5% PSC tax rate, reduced by ½% each January 1st until a ½% rate is fully phased-in on January 1, 2007.

Ex (52): ABC, a local telephone company, sells telecommunication access services to XYZ, a long-distance telecommunications provider, which resells the access services to customers making long-distance telephone calls. The gross income received by ABC from the sale of access services qualifies for the lower PSC tax rate beginning with the January 1, 2001 filings. XYZ is subject to the GET at the rate of 4 % as provided under HRS § 237-13(6).

B. Transportation services resold by a contractor

1. Under prior law, the gross income received by a motor carrier for transportation services provided to a construction industry contractor was subject to the PSC tax at the rate of 4%.
2. Act 198 provides that beginning with the January 1, 2001 filings, a motor carrier qualifies for a reduced PSC tax rate of 3.5%, reduced by ½% each January 1st until a 0.5 percent rate is fully phased-in on January 1, 2006.
3. A "motor carrier" is defined in HRS § 239-1, as a common carrier or contract carrier transporting freight or other property on the public highways other than a public utility or taxicab.
4. Transaction that qualifies:
 - a. Transportation services are provided by a motor carrier to a contractor (as defined in HRS § 237-6);
 - b. The benefit of the transportation services passes to the customer of the contractor;
 - c. Transportation services become an "identifiable element" of the contracting sold to the customer;
 - d. "Overhead" not eligible. Same definition as Act 71; and
 - e. The gross income of the motor carrier is not subject to income splitting under HRS § 239-2; and

f. The contractor does not take a GET subcontract deduction for the amounts paid to the motor carrier.

Ex (53): Trucking company hauling building materials to a building contractor's project site qualifies for the lower PSC tax rate.

Ex (54): Refuse company hauling trash from a project site qualifies for GET pyramiding relief instead of PSC tax relief. (Refuse company is a GET taxpayer.)

IV. QUALIFYING AND NON-QUALIFYING GET AND PSC ACTIVITIES

➤ Activity categories are **terms of art** specifically defined by law. If the activity does not meet the definition of activities designated in ACT 71 and ACT 198, it will **not** qualify for the lower rate.

A. Defining the qualifying activities:

1. "Service": person taxable under HRS § 237-13(6) and defined in HRS § 237-7.
2. "Contracting": person taxable under HRS § 237-13(6) and defined in HRS § 237-6.
3. "Transient accommodations": person taxable under HRS §§ 237-13(10) and 237D-2.
4. "Amusement": person taxable under HRS § 237-13(4) and defined in Act 198 as entertainment provided as part of a show for which there is an admission charge.
Subcontracted amusement with the sale of food and beverage is deemed to be an admission charge.
5. "Public utility" selling telecommunication services.
6. "Motor carrier" selling its products or services to a contractor.

B. Activities that do NOT qualify:

1. Leasing (reported as rental income taxed under HRS § 237-13(10)).
2. Sales representatives commission (income taxable under HRS § 237-13(5)).
3. Insurance agents (HRS § 237-13(7)).
4. Other activity taxable under (HRS § 237-13(10)).
5. Amusement or theater subject to income splitting treatment under HRS § 237-18(b).
6. Transportation services provided by motor carriers to freight forwarders.
7. Activities eligible for income splitting treatment:

(a) Tour packagers: HRS § 237-18(f)

Ex (55): Tour packager (with 10% commission rate) sells customer a bundled \$50 luau and \$50 tour for \$104.16. No pyramiding occurs when income splitting is permitted for GET purposes as the following sample GET reports show:

Taxpayer	Gross Receipts	Exempt/Ded	Net Receipts	Tax
Tour Packager	104.16	93.74	10.42	0.42
Luau Operator	46.87	0.00	46.87	1.87
Tour Operator	46.87	0.00	46.87	1.87

(b) Real Estate Brokers: HRS § 237-18(e)

Ex (56): Real estate broker closes studio apartment sale for \$100,000 with 6% commission, divides with listing broker as the following sample GET reports show:

Taxpayer	Gross Receipts	Exempt/Ded	Net Receipts	Tax
Selling Broker	6,000.00	3,000.00	3,000.00	120.00
Listing Broker	3,000.00	0.00	3,000.00	120.00

(c) Subcontract Deduction: HRS § 237-13(3)

Ex (57): Prime contractor builds a building for \$1 million (including tax) and subcontracts the following (including tax): Architect, \$40,000; Landscape architect, \$10,000; Electrical contractor, \$100,000; Plumbing Contractor, \$100,000. No pyramiding occurs when income splitting is permitted for GET purposes as the following sample GET reports show:

Taxpayer	Gross Receipts	Exempt/Ded	Net Receipts	Tax
Prime Contractor	1,000,000.00	250,000.00	750,000.00	30,000.00
Architect	40,000.00	0.00	40,000.00	1,600.00
Landscape Architect	10,000.00	0.00	10,000.00	400.00
Electrical Contractor	100,000.00	0.00	100,000.00	4,000.00
Plumbing Contractor	100,000.00	0.00	100,000.00	4,000.00

V. USE TAX PROVISIONS

► Act 71 amends the use tax law to take into account the GET pyramiding relief granted under the new law. Provides that the ½% use tax will apply to imports of TPP if the sale of that TPP would have qualified for pyramiding relief under Act 71 had the seller of the TPP been subject to the GET.

VI. EFFECTIVE DATES

- A. GET provisions apply to gross receipts received beginning January 1, 2000.
 - HRS § 237-3 relating to cash and accrual accounting methods applies.
- B. Use tax provision applies to taxes paid or incurred beginning January 1, 2000.
 - Use tax accrues when property or services are imported and become subject to the jurisdiction of the State. HRS § 238-2
- C. New lower GET rates for transactions including amusements that qualify under the new tests:

Phased-In Lower GET Rates for Qualifying Transactions		
Calendar Year	New Rate	Deduction
2000	3.5%	12.5%
2001	3.0%	25%
2002	2.5%	37.5%
2003	2.0%	50%
2004	1.5%	62.5%
2005	1.0%	75%
2006, thereafter	.5%	87.5%

Ex: Assume that the gross receipts from the qualifying transaction is \$1000.

Calculation Method:

Gross Receipts X Deduction Factor = Allowable Deduction

(Gross Receipts — Allowable Deduction) X 4% GET = Tax Liability

For year 2000, deduction is **12.5%**:

\$1000 X **12.5%** = \$125

\$1000 — \$125 = \$875

\$875 X .04 = **\$35.00 (Tax Liability)**

(Result is the same as if gross receipts were subject to a 3.5 % GET rate)

D. The taxpayer may use phased-in wholesale deduction worksheet to calculate the deduction (Form G-81).

E. PSC tax provisions in Act 198 are effective beginning with the January 1, 2001 filings. The lower tax rates apply to the gross income received by a public utility or motor carrier for the calendar year preceding January 1, 2001, and to calendar years thereafter. In the case of a public utility or motor carrier operating on a fiscal year basis, the lower PSC tax rates apply to the gross income received for the fiscal year in which January 1, 2001, occurs, and for fiscal years thereafter.

F. The PSC tax rate on the gross income of a motor carrier providing transportation services to a construction industry contractor follows:

Phased-In Lower PSC Rates for a Motor Carrier Qualifying under Act 198, SLH 2000	
Gross Income Year*	New Rate
2000	3.5%

Phased-In Lower PSC Rates for a Motor Carrier Qualifying under Act 198, SLH 2000	
Gross Income Year*	New Rate
2001	3.0%
2002	2.5%
2003	2.0%
2004	1.5%
2005	1.0%
2006, and thereafter	0.5%

* Under HRS § 239-4, the PSC tax is based on the gross income for the preceding taxable year. For example, the 2001 filing for a calendar year PSC taxpayer is based on the gross income of 2000.

G. The PSC tax rate on the gross income of a telecommunication services provider selling telecommunication services to a person selling interstate or foreign common carrier telecommunication services within and without the State described under HRS § 237-13(6), HRS, follows:²

Phased-In Lower PSC Rates for a Telecommunications Service Provider Qualifying under Act 198, SLH 2000	
Gross Income Year*	New Rate
2000	5.5%
2001	5.0%
2002	4.5%
2003	4.0%
2004	3.5%
2005	3.0%
2006	2.5%
2007, and thereafter	0.5%

* Under HRS § 239-4, the PSC tax is based on the gross income for the preceding taxable year. For example, the 2001 filing for a calendar year PSC taxpayer is based on the gross income of 2000.

² Subject to Technical Section review, the PSC pyramiding relief rates are used instead of the “deduction method” used for GET pyramiding relief. Form U-6 is not processed through the GEW system.

OUTLINE

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VII. RESALE CERTIFICATE FOR GET TAXPAYERS:

- A. Existing law - wholesale sales of property (Form G-17); intermediary services (Form G-16).
- B. Act 71 - HRS §§ 237-13(2)(F) and 237-13(6)(B) - (Form G-82).